Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *et al.*,
Appellees.
(and three consolidated cases)

On Appeal from and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

JOINT BRIEF OF LISTED PRIVATE RESPONDENTS

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November 1985

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QUESTIONS PRESENTED

1. Did the Federal Communications Commission correctly construe Section 220 of the Communications Act, 47 U.S.C. § 220, to make the FCC's depreciation rules and prescriptions for telephone plant used interchangeably in interstate and intrastate communication binding in state proceedings involving the same telephone plant?

2. Alternatively, did the FCC lawfully preempt inconsistent state regulation of depreciation where (a) the FCC rationally found that preemption was necessary to avoid frustration of federal policy and (b) inconsistent state regulation conflicted with federal rules lawfully adopted by the FCC?

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JOINT BRIEF OF LISTED PRIVATE RESPONDENTS

This brief is filed on behalf of 26 private parties who supported the Federal Communications Commission in the court below.[1] The position of this brief is that the Fourth Circuit's judgment is correct and should be affirmed.

STATEMENT OF FACTS

In 1980 and 1981, the Federal Communications Commission made substantive changes in its rules for determining depreciation of telephone plant in the United States which is used in common for interstate and intrastate communication.

[1] The names of the subscribing parties are set forth in Appendix A together with cross-references to information required by S. Ct. R. 28.1. The subscribing parties include telephone companies providing about 75 percent of the local telephone service in the United States.

Thereafter, the FCC ruled in 1983 that it would violate the Communications Act[2] for individual states to order telephone companies to depreciate the same telephone plant using depreciation rates or methods inconsistent with those adopted by the FCC. Alternatively, the FCC found that such inconsistent state regulation would frustrate federal policy designed to assure timely cost recovery and improved service. The Fourth Circuit upheld the FCC's preemptive decision.

A. The Statutory Plan and the Regulation of Depreciation

Virtually all of the telephone company facilities and equipment ("telephone plant") in the United States used to provide intrastate service is also used to provide interstate service.[3] Whether a call travels across the street or across the United States, it originates in the same telephone set or switchboard, uses the same "inside wiring" in the home or office, and traverses the same line to the switching facilities at the telephone company central office. In short, local telephone plant is used interchangeably for both interstate and intrastate service. From the standpoint of physical facilities, the United States has "a unified system of communication." [4]

Under the Act, the FCC has an overriding mandate "to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges." Section 1, 47 U.S.C. § 151. The FCC's jurisdiction under Section 2 of the Act, 47 U.S.C. § 152, and its express statutory powers over telephone companies extend to telephone plant commonly used for interstate and intrastate communication.[5]

[2] Communications Act of 1934 ("the Act"), 47 U.S.C. § 151, *et seq.* Pertinent provisions of the Act are reprinted in Appendix B.

[3] *North Carolina Utils. Comm'n* v. *FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*"NCUC I"*). Some telephone plant may be used only for interstate operation (*e.g.*, a cable connecting two cities in different states) but there is virtually no plant used for intrastate calls that is not also used or usable to carry interstate calls as well.

[4] *General Telephone Company* v. *FCC*, 413 F.2d 390, 401 (D.C. Cir.) (Burger, J.), *cert. denied*, 396 U.S. 888 (1969), affirming the FCC's "central authority" over that unified system.

[5] The provisions of Section 2 of the Act, the relevant definitional provisions, and the express powers are discussed in detail at pp. 32-38, below.

In regulating this commonly used plant, the FCC has repeatedly been sustained in preempting inconsistent state regulation, even though state commissions otherwise retain substantial authority over purely intrastate aspects of service.[6]

Section 220 of the Act, 47 U.S.C. § 220, the provision that lies at the heart of this case, gives the FCC plenary authority to prescribe depreciation for telephone plant for carriers subject to the Act. Depreciation measures the loss of service value of a capital asset over time by allocating the asset's cost, through an annual depreciation expense, to the individual years in which the asset is usefully in service. The depreciation expense is reflected in rates for the services provided by the carrier (although rates are also affected by many other determinations). Because local telephone plant is used for both interstate and intrastate services, the depreciation expense for such plant affects—but does not determine—both interstate and intrastate rates.

To illustrate depreciation, assume that a carrier's line connecting a house with the local central office costs $100 and is expected to last 10 years. The FCC's standard method—"straight line" depreciation—would assign $10 per year as an expense to be recovered through telephone rates for 10 years. In addition, the FCC also has authority to "separate" the expense by allocating a part of the $10 per year to interstate rates and the balance to intrastate rates.[7] Thus, if 25 percent of the line's cost were allocated by the FCC to interstate service and 75 percent to intrastate service, that carrier would be entitled to include each year $2.50 in its interstate revenue requirement and $7.50 each year in its intrastate revenue requirement until the investment had been recovered at the end of ten years. Although depreciation therefore affects rates at both the interstate and intrastate levels, it represents only about 10-15 percent of overall revenue requirements and is only one

[6] The provisions relating to intrastate service (Sections 2(b) and 221(b), 47 U.S.C. §§ 152(b), 221(b)), and the cases construing these provisions in light of the FCC's preemptive authority, are discussed at pp. 31-38, below.

[7] See Sections 221(c) and 410(c) of the Act, 47 U.S.C. §§ 221(c), 410(c), discussed at pp. 14-15, below.

of a number of elements that influence the ultimate level of customer charges. See pp. 34-35, below.[8]

Section 220(b) of the Act directs that the FCC "shall" prescribe depreciation for carriers subject to the Act. It also forbids such carriers from depreciating "any" property, or using "any" depreciation charges other than as prescribed by the FCC (*id.*), unless under Section 220(h), 47 U.S.C. § 220(h), the FCC excepts carriers from Section 220 and permits the states to regulate instead. Congress required the FCC to consider the "views and recommendations" of the states before adopting or altering accounting requirements including depreciation (Section 220(i), 47 U.S.C. § 220(i)) but deliberately rejected a proposed amendment to Section 220 urged by the state commissions that would have permitted them to ignore FCC depreciation and to set different depreciation for use in intrastate ratemaking. See pp. 16-18, below.

For almost 50 years, the FCC has maintained rules governing the depreciation of telephone plant. Since the 1930's, the FCC has prescribed and revised the Uniform System of Accounts for telephone companies including rules to determine the categories of plant that may be depreciated and the methods of depreciation.[9] In addition, since the late 1940's the FCC has prescribed specific depreciation rates for larger individual telephone companies subject to the Act; these prescription orders take account of variations in local conditions and are revised periodically, normally on a three-year cycle.[10]

[8] Combining data for AT&T Communications and most of the local telephone companies, depreciation in 1984 represented about 12% of revenues. United States Telephone Association, *Statistics of the Telephone Industry* 17 (1985); AT&T Communications, *Annual Report to the FCC*, 58-60 (1984).

[9] See *Telephone Division, Order No. 7-C*, 1 F.C.C. 45 (1935). For example, under the current rules, 47 C.F.R. § 31.02-82 specifies categories of depreciable plant for larger companies and § 31.02-80 treats depreciation methods.

[10] When a telephone company does business in more than one state, the FCC may prescribe different depreciation rates for the carrier's plant located in the different states. See, *e.g.*, *In re Prescription of Revised Percentages of Depreciation*, 96 F.C.C.2d 257, 281-85 (1983), *recon. denied*, 99 F.C.C.2d 117 (1984) (prescribing different depreciation rates for Northwestern Bell property in five different states).

States have normally accepted FCC depreciation decisions without contest. See p. 21, below.

B. The FCC's 1980 and 1981 Depreciation Rules

In 1980 and 1981, the FCC revised certain of its depreciation rules.[11] Its objective was to ensure that the telephone companies be permitted to use modern depreciation methods that accurately reflect the actual rate of depreciation of telephone plant, thereby permitting timely recovery of invested capital. The need for accuracy and timely cost recovery had been greatly increased by new communications technology,[12] the growth of competition, and reduced regulation in the telephone industry.[13] More rapid technological change makes existing facilities obsolete more quickly and, unless the plant is depreciated accurately, a carrier may be left at the end of the plant's useful life with a substantial part of its investment not recovered. Competition increases the speed of technological change and limits a carrier's ability to recover undepreciated investment after the equipment has been retired.

If telephone companies cannot use accurate depreciation methods and rates to recover costs as plant is consumed, they —and the investors who supply new capital to them—are inhibited in making new investments. One consequence is that telephone customers do not get the benefit of new technology that would improve service, lower telephone rates over the long

[11] *In re Amendment of Part 31*, 83 F.C.C.2d 267 (1980) (J.A. 4), *recon. denied*, 87 F.C.C.2d 916 (1981) (J.A. 45); *In re Amendment of Part 31*, 85 F.C.C.2d 818 (1981). References to "J.A." are to the joint appendix in this case; references to "Cal. Pet. App." are to the appendix to California's petition for certiorari in No. 84-889.

[12] Dramatic examples of new technology are the increasing use of microwave and satellite radio systems in place of landline cables and the use of electronic computer-controlled switching systems both within the network and in individual pieces of telephone equipment such as customer switchboards.

[13] Landmarks in the advent of competition are *North Carolina Utils. Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) ("*NCUC II*") (registration of customer provided telephone equipment), and *Washington Utils. & Transp. Comm'n* v. *FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975) (competition for specialized intercity services).

run and serve Congress' explicit goal to "make available . . . a rapid, efficient, Nation-wide . . . communication service . . . ." Section 1 of the Act. The other consequence of inadequate depreciation is that the telephone companies' books show an ever larger amount of undepreciated investment representing plant that has become obsolete and is no longer capable of producing earnings.[14] This in turn increases their borrowing costs, leading to increased customer rates, and ultimately threatens the companies' financial stability and their ability to raise capital.

In 1980 and 1981, after very extensive study including the receipt of comments from both carriers and state commissions, the FCC made three major changes to modernize depreciation:

SLELG. The FCC directed that the telephone companies subject to the Act be allowed to use the so-called "Straight Line Equal Life Group" methodology ("SLELG") in computing depreciation. The grouping of items of telephone plant is essential for computing depreciation in this industry, because there are millions of pieces of plant. SLELG is a method of grouping individual items of plant which creates smaller and more homogeneous groups than were utilized under the so-called "vintage group" method used by telephone companies in the past.[15] Based on overwhelming evidence, the FCC found that SLELG more accurately depicts actual straight line depreciation. See pp. 24-25, below.

[14] One estimate of the "reserve deficiencies" of the nation's local telephone companies is that they now total $26 billion. See Gold, *The $26 billion solution*, Forbes 40 (July 29, 1985). Without making its own computation, the National Telecommunications and Information Administration has described the reserve deficiencies as "substantial" in magnitude and "growing rapidly." NTIA, *Issues in Domestic Telecommunications: Directions for Domestic Policy* 142 (1985) ("NTIA Report"). Reserve deficiency refers to the differential between the actual consumption of telephone plant and the smaller, inadequate depreciation allowed by regulators.

[15] A brief description of SLELG and vintage group depreciation is provided in Appendix C. Under SLELG, straight line depreciation is applied to each "equal life" group. SLELG is not an "accelerated" depreciation method; rather, by more accurately computing straight line depreciation, SLELG overcomes a lag effect inherent in the vintage life method of grouping. See p. 24, below.

Remaining life. The FCC's second reform was to direct that subject carriers use a convention called "remaining life" for making mid-course corrections of past discrepancies in depreciation. It may be discovered after several years that the original rate of depreciation used for a category of plant does not match actual experience and that the plant is actually depreciating more quickly than the rate at which depreciation is being recovered through customer charges.[16] The remaining life convention approved by the FCC has a cardinal advantage over the "whole life" convention previously used by telephone companies to cope with mid-course corrections: under remaining life, the new rate of depreciation is reset after the correction to make certain that at the end of the actual useful life of the plant, the total depreciation recovered by the company will equal the net investment.[17]

Inside wiring. The third change made by the FCC was to direct that a set of plant expenditures called "inside wiring" should no longer be capitalized and depreciated by subject carriers but should be treated as an expense to be recovered in the year incurred.[18] The category of inside wiring to be expensed was one that the FCC had already found, several years earlier, was properly associated with the individual customer who placed the order.[19] The FCC found that ex-

[16] A depreciation rate, whether for an individual item of telephone plant or for a homogenous group, is normally derived by estimating the useful service life of the plant and allocating the net investment (the original cost less salvage value) evenly across the years of useful life. Especially during rapid technological change, actual experience with retirements of plant may reveal that the average life is shorter than expected so that the depreciation rate originally used is too low.

[17] A brief description of the remaining life and whole life conventions is provided in Appendix C. The main problem with whole life is that, by ignoring the inadequate depreciation already taken when the correction is made, whole life virtually assures that a carrier will have underrecovered the net investment at the end of the plant's useful life. See pp. 24-25, below.

[18] The FCC has express authority under Section 220(b) to determine *whether* a category of plant shall be depreciated, as well as to determine the depreciation rates for depreciable plant. See pp. 12-13, below.

[19] See *In re AT&T*, 64 F.C.C.2d 1, 54-56 (1977) (certain of the expenditures on material and labor costs incurred in installing inside wiring do not benefit subsequent occupants).

pensing those costs would avoid placing the burden on future customers who did not cause, and were not advantaged by, the expenditures. 85 F.C.C.2d at 828-29.

A number of the state commissions participated in the proceedings that led the FCC to reach its decisions concerning SLELG, remaining life and the expensing of inside wiring. Some objected to the use of SLELG or remaining life as increasing short-run revenue requirements for the carriers. In the expensing of inside wiring, states were divided in their views. After the FCC issued its decisions in 1980 and 1981, none of the states sought judicial review of the new depreciation rules.

C. The FCC's Preemption Decision and Judicial Review

During the FCC proceedings that led to the 1980 and 1981 rule changes, it had been taken for granted that the states would continue to respect the FCC's depreciation decisions, as they normally had done in the past. Nevertheless, following the FCC's new rules, NARUC [20] and the California Commission asked the FCC in April 1981 to rule that the states were free to ignore FCC depreciation requirements.

On April 27, 1982, the FCC issued a decision on the NARUC-California request. *In re Amendment of Part 31*, 89 F.C.C.2d 1094 (Cal. Pet. App. A-26). By a four-to-three vote, the FCC declined to read Section 220 as automatically compelling the states to follow FCC depreciation decisions. The FCC reaffirmed its own authority to preempt inconsistent state action that would interfere with FCC policy;[21] but it found no immediate need to exercise that authority, because, as it later explained, it expected state commissions to continue their ordinary practice of following FCC depreciation rulings. *In re Amendment of Part 31*, 92 F.C.C.2d 864, 866-67 (1983) (Cal. Pet. App. A-58-59).

[20] NARUC, the National Association of Regulatory Commissioners, regularly litigates on behalf of the state commissions and represents their interests in congressional hearings.

[21] "Section 2(b) does not prohibit [FCC] preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications." 89 F.C.C.2d at 1108 (Cal. Pet. App. A-48).

AT&T and GTE promptly asked the FCC to reconsider its decision.[22] On January 6, 1983, the FCC released its Preemption Order, unanimously ruling that its depreciation decisions did preempt conflicting state regulation. It rested its Preemption Order on two independent grounds:

First. Based on reexamination of Section 220(b) and its legislative history, the FCC concluded that FCC decisions on depreciation for subject carriers automatically bind the state commissions. It found that this reading was confirmed by Section 220(h) which permits the FCC to substitute state regulation and by Section 220(i) which invites states to provide their "views and recommendations" to the FCC. Further, the FCC found that Section 220 reenacted a provision that had given the ICC preemptive authority over depreciation rates and that Congress specifically had refused to alter the existing preemptive language to give the states a right to set their own depreciation rates.

Second. Apart from automatic statutory preemption, the FCC found that preemption was necessary to avoid frustration of federal policy.[23] The FCC found that depreciation is a significant cost that must be recovered in both interstate and intrastate rates, and that state rules that understate depreciation harm the network: such harms include inadequate capital recovery by carriers, injury to the carriers' ability and incentive to modernize their plant, and ultimately loss of new facilities and improved service for the public.

The FCC's Preemption Order was limited solely to requiring respect for its depreciation decisions; it did not preempt the

[22] J.A. 66; J.A. 122. AT&T's petition for reconsideration urged the agency to reexamine the question of automatic preemption under Section 220(b) in light of legislative evidence on which the FCC had not focused. A General Telephone subsidiary, providing telephone service in Ohio, filed a petition for a declaratory ruling showing that the Ohio Commission had already forbidden the use of SLELG and remaining life and urging the FCC to preempt in order to avoid widespread frustration of its policy. J.A. 89.

[23] Contrary to its initial expectation in 1982, the FCC found that a number of states had already declined to follow its new depreciation rules. Thirteen states had refused to accept SLELG and 9 states had rejected remaining life. 92 F.C.C.2d at 877 n.14 (Cal. Pet. App. A-76).

states in determining the ultimate rates to be charged to customers for intrastate services. 92 F.C.C.2d at 879-80 (Cal. Pet. App. A-79-80). Nevertheless, a number of state commissions joined in seeking judicial review of the Preemption Order in the Fourth Circuit.[24] In June 1984, the Fourth Circuit sustained the FCC's Preemption Order on the ground that the FCC had authority to preempt state regulation that conflicted with federal agency rules and thwarted federal policy for the network.[25]

The FCC's Preemption Order has now been in effect for almost three years and has been respected by most state commissions. Where state agencies have sought to disregard the order, district courts have normally enforced the FCC's depreciation requirements in injunction actions.[26] The phase-in process for SLELG and remaining life is now essentially complete, and the FCC's new prescriptions of depreciation for subject carriers normally reflect SLELG and remaining life depreciation.

SUMMARY OF ARGUMENT

1. The FCC correctly construed Section 220 of the Act to make FCC depreciation decisions for carriers subject to the Act binding on the state commissions. Congress directed the FCC to prescribe depreciation (Section 220(b)), prohibited carriers from using "any" depreciation other than that prescribed by the FCC (*id.*) unless the FCC affirmatively delegated authority to the states (Section 220(h)), and took account of state interests by requiring the FCC to consider the "views and recommendations" of state commissions (Section 220(i)). Section 220 reenacted a provision of the Interstate Commerce Act that had already been construed by the ICC as giving it preemptive power to determine depreciation for both railroad and telephone plant. In reenacting this provision in the Communications Act, Congress considered and specifically rejected an amendment urged by the state commissions which would have empowered them to set different depreciation rates for intrastate rate proceedings.

2. Independent of statutory preemption, preemption by federal agency action occurs where, as here, the agency reasonably determines to preempt in order to prevent the frustration of federal policy. *Capital Cities Cable, Inc.* v. *Crisp*, 104 S. Ct. 2694 (1984) ("*Crisp*"). The FCC found in this case that new federal depreciation rules which ensure accurate depreciation were needed to achieve timely capital recovery and to provide incentives vital to modernizing the nation's telephone network. Because the same plant is used in common for both interstate and intrastate communications, the investment must be recovered through both interstate and intrastate rates; and inadequate state-ordered depreciation would frustrate the federal objectives by impairing timely capital recovery and inhibiting new investment in the network. In addition, inconsistent state depreciation conflicts with the FCC's own new depreciation rules, and state regulation in conflict with lawful federal rules is therefore preempted. See *Free* v. *Bland*, 369 U.S. 663 (1962).

3. Preemption of inconsistent state regulation of depreciation is not barred by Section 2(b)(1) of the Act which reserves to the states authority over intrastate customer charges and related subjects. Congress specifically gave the FCC overriding authority over depreciation for subject carriers in Section 220 and "specific terms prevail over the general" in statutory construction. *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U.S. 222, 228 (1957). Moreover, the language and legislative history of Section 2(b)(1) show that it was directed to preventing the FCC from setting individual customer charges for intrastate services, which the FCC has not done in this case.

[24] Under the Hobbs Act, the Fourth Circuit thereby acquired "exclusive jurisdiction" to review the decision. 28 U.S.C. § 2342. See *FCC* v. *ITT World Communications, Inc.*, 104 S. Ct. 1936 (1984).

[25] *Virginia State Corporation Commission* v. *FCC*, 737 F.2d 388 (Cal. Pet. App. A-1). One judge, who had earlier dissented in both *NCUC I* and *NCUC II*, dissented from both the panel decision and the denial of rehearing *en banc*. In none of the Fourth Circuit cases has any other judge agreed with the petitioners' position.

[26] This Court has agreed to review one such decision to address procedural issues under Section 401. *Public Service Commission of Maryland* v. *C&P Telephone Co.*, *cert. pending*, No. 84-1362.

Finally, the FCC's holding that Section 2(b)(1) is inapplicable rests on a consistent line of decisions in the courts of appeals which this Court has repeatedly declined to review.

ARGUMENT

I. THE FCC REASONABLY CONSTRUED SECTION 220 OF THE ACT TO REQUIRE THE USE OF FCC PRESCRIBED DEPRECIATION IN STATE PROCEEDINGS FOR CARRIERS SUBJECT TO THE ACT.

Under well established doctrine, state regulation is foreclosed when Congress itself has made a *statutory* determination to override state regulation, by expressly so providing, by implication, by occupying the field, or by any other means that makes Congress' intent clear.[27] Here, Section 220 of the Act requires that the FCC's depreciation decisions preempt state regulation. The FCC's interpretation of the statute accords with both the language and legislative history of Section 220, and is entitled to special weight because the expert agency has diligently reexamined the complex statute it is assigned to administer and has unanimously settled on a reasoned interpretation.[28]

A. The Language and Structure of Section 220 Show That FCC Depreciation Decisions Bind the States.

Congress' intent is, first and foremost, to be sought in its statutory language.[29] Section 220(b) says that the FCC "shall"

[27] See, *e.g.*, *Shaw* v. *Delta Air Lines, Inc.*, 463 U.S. 85, 95 (1983) (preemption "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose"), quoting *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 152-53 (1982), and *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977).

[28] *Chemical Mfrs. Ass'n* v. *NRDC*, 105 S. Ct. 1102, 1108 (1985) (agency interpretation due "considerable deference"); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (same); *NLRB* v. *Local Union No. 103*, 434 U.S. 335, 351 (1978) (new agency interpretation adopted on reexamination of statute entitled to weight).

[29] *E.g.*, *Park 'N Fly, Inc.* v. *Dollar Park and Fly, Inc.*, 105 S. Ct. 658, 662 (1985); *Kosak* v. *United States*, 104 S. Ct. 1519, 1523 (1984); *INS* v. *Phinpathya*, 104 S. Ct. 584, 589 (1984).

prescribe classes of carrier depreciable property and the percentage of depreciation to be charged for each class.[30] Section 220 applies by its terms to *all* carriers subject to the Act.[31] Section 220 is not qualified by language limiting its application only to interstate communication; by contrast, other provisions of the Act, requiring that tariffs be filed with the FCC and that rates be reasonable, apply only to "interstate and foreign communication." Sections 201, 203, 47 U.S.C. §§ 201, 203.

Section 220(b) bears out Congress' intent that carriers be governed by one regime for depreciation by directing that subject carriers "shall not" charge depreciation for "any" class of property or utilize "any" depreciation percentages other than as prescribed by the FCC.[32] Other provisions of Section 220 forbid such carriers from keeping any accounts, records and memoranda other than those prescribed or approved by the FCC unless the FCC authorizes additional, state-requested data.[33] If Congress had intended that different depreciation accounts be kept by carriers for state ratemaking purposes, it would not have included this blanket prohibition.

The role of the states in depreciation is directly addressed in Section 220(i). That subsection provides that the FCC, before exercising its authority under Section 220, "shall notify" the state commissions and provide an opportunity to the states to "present [their] views" and shall "consider such views and

[30] The first sentence of Section 220(b) reads in full: "The Commission shall, as soon as practicable, prescribe for [carriers subject to the Act] the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose."

[31] Section 2(a) of the Act makes it applicable not only to interstate communication but also to anyone who engages in such communication.

[32] The third sentence of Section 220(b) provides: "[Carriers subject to the Act] shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission."

[33] See Sections 220(d) and (g), 47 U.S.C. §§ 220(d), (g). See also p. 22, n.57, below.

recommendations." Congress gave the states an opportunity to present their views because it expected them to be bound by the resulting prescriptions.[34] Section 220(h) permits the FCC to "except" carriers from its decisions under Section 220 and permits separate state regulation only when the FCC expressly finds that such action would be "consistent with the public interest."[35] Unless the FCC affirmatively exercises its discretion under Section 220(h) to waive or delegate its authority, the states cannot adopt inconsistent regulations.

Taken together, the provisions of Section 220 that apply to depreciation form a coherent whole. Congress clearly intended that there be one regime—rather than multiple regimes—of depreciation for each subject carrier. The FCC was given responsibility for establishing such a regime, and its depreciation decisions have to be respected unless and until it relinquishes authority to the states in individual instances. The states' interest is recognized but their role is confined to providing their "views and recommendations."[36]

Congress' decision to give the FCC overriding authority over depreciation conforms to the approach used elsewhere in the Act in like circumstances. In particular, the FCC alone makes the final decision in separations proceedings to allocate common investment between the interstate rate base and the intrastate rate base under Section 221(c) and 410(c) of the Act;[37] this final authority exercised by the FCC directly affects the regulation of both interstate and intrastate communication.

[34] The very fact that the FCC is required to notify the states and consider their views or recommendations is because states will be bound by the outcome. See *Shields* v. *Utah I.C. R.R.*, 305 U.S. 177, 182 (1938).

[35] Section 220(h) reads in pertinent part: "The Commission . . . may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates."

[36] Where Congress has wanted to authorize a state to use depreciation rates inconsistent with those fixed by the federal agency, it has said so explicitly. *E.g.*, Natural Gas Act, § 9(a), 15 U.S.C. § 717h(a).

[37] Section 410(c); H.R. Rep. No. 429, 92nd Cong., 1st Sess. 3 (1971) ("the State board members would not vote on the final decisions"). See *Illinois Bell Tel. Co.* v. *Illinois Commerce Comm'n*, 740 F.2d 566, 567 (7th Cir. 1984) (FCC has "final authority" over separations).

Once again, state interests are safeguarded by permitting the states to vote on a "recommended decision" on separations prepared by a joint federal-state board. *Id.*

In each case, Congress saw that the subject matter required one agency—the FCC—to have the last word. Obviously, when investment in common plant is "separated" between the interstate and intrastate rate bases, someone must make the final decision on the formula to be used, so that the separated portions will add up to 100 percent. Similarly, it is not surprising that Congress recognized that an individual piece of commonly used telephone plant located in one place depreciates at a single rate, and empowered the FCC to determine that rate.[38]

B. The Legislative History of Section 220 Confirms That Congress Intended to Preempt Inconsistent State Depreciation and Rejected a Proposal to Allow States to Set Different Depreciation Rates.

The legislative history of Section 220 confirms Congress' specific intent that, once the FCC has prescribed depreciation for subject carriers, inconsistent state regulation must give way. Until passage of the Communications Act in 1934, telephone companies were regulated by the Interstate Commerce Commission (see 36 Stat. 544-45), and the Interstate Commerce Act was the model for the new Communications Act.[39] Section 220's core provisions reenact, almost verbatim, Section 20(5) and related provisions of the Interstate Commerce Act. Section 20(5) (set forth at p. 5b, below) was enacted in 1920 (41 Stat. 493-94) to require the ICC to prescribe depreciation for both telephone companies and railroads.

[38] Due to local conditions (*e.g.*, weather, volume of usage), items of plant may deteriorate more quickly in one part of the country than in another; but the FCC's depreciation prescriptions do provide different depreciation rates in those circumstances. See p. 4, above.

[39] Interpretations of the Interstate Commerce Act therefore have been given great weight in interpreting the Communications Act. See, *e.g.*, *ABC* v. *FCC*, 643 F.2d 818, 820-21 (D.C. Cir. 1980); *AT&T* v. *FCC*, 449 F.2d 439 (2d Cir. 1971).

When the Communications Act was being framed, Section 20(5) of the Interstate Commerce Act had already been construed as preempting state depreciation if and when the ICC exercised its power to prescribe depreciation.[40] This reading of Section 20(5) as preempting state authority was no secret to Congress; the state commissions had been urging the repeal or amendment of Section 20(5) throughout the 1920's,[41] and they opposed its reenactment as part of the new Communications Act precisely because of its preemptive effect. In hearings in 1930 on an early version of the new Act, NARUC and various state commissions argued that reenactment of Section 20(5) in the Communications Act would destroy state regulatory power, warning that reenactment would enable the new FCC to take over "all matters of depreciation . . . without regard to the action upon the same subject by the State Commission." [42]

By 1934, the state commissions had persuaded the drafters to add a new Section 220(j) to the revised bills introduced for consideration that year. This new Section 220(j)—which was not enacted—would explicitly have permitted the states to prescribe their own depreciation requirements for purposes of

[40] See *Depreciation Charges of Telephone Companies* and *Depreciation Charges of Steam Railroad Companies*, decided together at 118 I.C.C. 295, 330 (1926), *further proceedings*, 177 I.C.C. 351 (1931). NARUC did not contest the ICC's power to preempt but urged it not to do so as a matter of discretion; the ICC rejected the request. 118 I.C.C. at 330. See also *Accounting Rules for Telephone Companies*, 203 I.C.C. 13, 17 (1934).

[41] Resolutions to this end were passed at NARUC conventions repeatedly. See *Hearings on S.2910 Before the Senate Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 184 (1934) (statement of NARUC representative).

[42] *Hearings on S. 6 Before the Senate Comm. on Interstate Commerce*, 71st Cong., 2d Sess. 2243 (1930) (resolution of Montana Commission); *id.* at 2213-17 (statement of NARUC representative). S. 6, 71st Cong., 1st Sess. § 37(b) (1930), was derived from Section 20(5) and is practically identical to the present Section 220(b).

determining intrastate rates.[43] This provision was introduced at the direct request of the state commissions[44] and was contained in the version of the bill reported by the House Committee and passed by the House itself. Significantly, the House report acknowledged that its version of Section 220(j) would have altered existing law, stating:

> "[The provision is] responsive to the requests of the State commissions that *the present law be changed* so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting." H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934) (emphasis added).[45]

However, while the states were seeking to prevent reenactment of Section 20(5), both the ICC and the telephone companies were strongly opposed to the proposed NARUC modification, especially in the Senate. The ICC spokesman testified that the NARUC proposal "directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law." [46] As a result, the

[43] Section 220(j), as initially proposed in H.R. 8301, 73rd Cong., 2d Sess. § 220(j) (1934), and S. 2910, 73rd Cong., 2d Sess. § 220(j) (1934), provided that nothing in Section 220 would

> "limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices . . . ."

[44] See *Hearings on S. 2910*, *supra*, at 179 (statement of Senator Dill); *id.* at 184 (statement of NARUC representative).

[45] A similar explanation of the proposed Section 220(j), as "a change necessary" to permit the state commissions to prescribe depreciation, was given by the Chairman of the House Committee in a House debate (78 Cong. Rec. 10,314 (1934) (Rep. Rayburn)) and by the NARUC spokesman. See, *e.g.*, *Hearings on S. 2910*, *supra*, at 181 (statement of NARUC representative).

[46] *Hearings on S. 2910*, *supra*, at 208 (1934). A similar, very extensive attack on the notion of dual systems of depreciation as a prelude to "chaos" was made by AT&T's president and echoed by the spokesman for the association representing independent telephone companies. *Id.* at 95-96 (statement of AT&T president); *id.* at 139-40 (statement of USITA president).

Senate Committee reported, and the Senate adopted, a quite different version of Section 220(j) which (unlike the House-passed bill) did not reserve *any* authority to the state commissions; it merely directed the FCC to investigate and report on the need for legislation to grant authority to the states in the future.[47]

When the conflicting versions of Section 220(j) reached the Conference Committee, that committee framed the final language of Section 220 contained in the enacted version. The Conference Committee included in the final statute the present Section 220(h), which the House had enacted to permit the FCC to delegate authority over depreciation or other accounting to the state commissions *if* the FCC chose to do so. However, in Section 220(j), the Conference Committee adopted a more general version of the Senate provision, which retained existing federal authority and called for an investigation into the need for further legislation.[48]

The result can be briefly summarized. Congress enacted in Section 220 depreciation provisions that it knew had been construed by the responsible agency to give that agency preemptive authority over depreciation. Standing alone, that reenactment would itself be strong evidence of Congress' intent

[47] See S. 3285, 73rd Cong., 2d Sess. § 220(j) (1934), reported as a substitute for S. 2910. As the Senate report explained, its version of Section 220 retained existing federal authority over accounting and depreciation for the time being. S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934). NARUC testified that the House bill was "all right" and the revised Senate bill was "all wrong" on the issue of state authority over depreciation. *Hearings on H.R. 8301 Before the Senate Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 137 (1934). NARUC's representative admitted that the Senate's revision of Section 220(j) had responded to AT&T's criticisms. *Id.* at 140.

[48] See H.R. Rep. No. 1918, 73rd Cong., 2d Sess. 47 (1934) (Conference Report). Section 220(j) as passed by Congress is essentially a condensed version of Section 220(j) as passed by the Senate. "The obvious inference to be drawn is that the conferees were not prepared at that time to allow the states to prescribe depreciation rates different than those established at the federal level, but the matter might be considered later if the report required by Section 220(j) indicated it to be appropriate." 92 F.C.C.2d at 873 (Cal. Pet. App. A-69).

to preserve existing authority.[49] Even more telling, Congress considered and then explicitly refused to enact the NARUC sponsored provision—the House version of Section 220(j)—that would have given the states authority to set different depreciation rates for intrastate proceedings.[50] The states are now seeking from this Court the very power that Congress deliberately refused to grant them in 1934.

C. The FCC's Reading of Section 220 Is Consistent Both With Its Regulatory Purpose and With Prior Practice Under the Act.

Faced with the preemptive language of Section 220(b) and its legislative history, the Louisiana brief filed by three of the petitioners [51] claims that the FCC's depreciation and accounting prescriptions under Section 220 are simply irrelevant in determining the costs to be used in establishing a carrier's revenue requirements. In substance, Louisiana argues that the FCC's actions under Section 220 involve merely "a system of notation" for record-keeping purposes and have no substantive import. La. Br. 27; *id.* at 5-8, 26-28, 37-38. Resting on a jumble of out-of-context quotations and misdescriptions, the claim is flatly wrong and would reduce Section 220 to "a feeble gesture." 92 F.C.C.2d at 870 (Cal. Pet. App. A-64).

The cardinal importance of depreciation to utilities is *precisely* its impact upon the carrier's revenue requirement. Depreciation affects both the carrier's net investment on which

[49] *E.g., Lindahl* v. *OPM*, 105 S. Ct. 1620, 1629 n.15 (1985); *Lorillard* v. *Pons*, 434 U.S. 575, 580-81 (1978).

[50] This refusal is strong evidence of Congress' intent. *E.g., Baldridge* v. *Shapiro*, 455 U.S. 345, 357-58 (1982); *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 35-36 (1981).

[51] One petitioner brief has been joined by Louisiana, Ohio and Florida ("La. Br."); the other petitioner brief, joined by California, NARUC, and a number of state commissions ("Calif. Br."), places its main stress on a jurisdictional argument considered in part III below.

it is allowed to earn a return and the level of expenses that it may recover.[52] This central role of depreciation in the economic regulation of carriers explains why Congress made it mandatory for the FCC to regulate depreciation in Section 220 and why the FCC has expended so much time and energy in establishing depreciation rules and prescribing depreciation rates for individual major carriers. It also explains why NARUC in the 1920's urged the ICC not to prescribe depreciation[53] and why NARUC fought so vigorously in the 1930's, without success, to prevent the enactment of Section 220 in its current form. See pp. 16-17, above.

The scraps of quotation offered by Louisiana, in support of its "notation" argument, dissolve on examination. In general, they concern accounting matters other than depreciation and merely make clear that the entry of an item into a particular account does not resolve every ratemaking question that can arise.[54] The few cited cases that do relate to depreciation confirm that depreciation directly affects a carrier's revenue requirement; and none of the cited cases involving depreciation adopted Louisiana's "notation" argument. See p. 21, below. It is not surprising that Louisiana's argument was scarcely presented in the briefs filed in the court below.

[52] Thus, an increase in depreciation (1) increases the immediate depreciation expense (and lessens the amount of depreciation remaining to be taken) and (2) reduces the net investment on which a return is earned. See P. Garfield & W. Lovejoy, *Public Utility Economics* 95-96 (1964). Accordingly, the increase in depreciation means that customers ultimately pay fewer dollars: the total depreciation expense over the life of the investment remains the same (original investment less salvage value) but the total return on investment is less, because the net investment declines more rapidly.

[53] NARUC argued that if depreciation "is to be fixed by the Federal Government" and applied to "local properties of telephone companies where used to some extent in interstate toll service . . . [then much] of the total revenue which the State commissions must provide in establishing rates will be for purposes entirely removed from any jurisdiction of those commissions." See *Depreciation Charges, supra*, 118 I.C.C. at 330.

[54] This, in substance, is what the FCC represented to this Court in *AT&T* v. *United States*, 299 U.S. 232 (1936), when it said that accounting would "not necessarily" determine ultimate treatment in ratemaking. For example, an expense may be properly classified under the FCC's system of accounts but may be disallowed as an expense (*e.g.*, because it is excessive or unnecessary).

The Louisiana brief also asserts that the FCC's reading of the Act is inconsistent with "50 years of history." La. Br. 2-3. It would be wrong to expect perfect uniformity over a half century, but actual practice supports the FCC's position. The FCC established rules for depreciation as early as 1935 and, by the end of the 1940's, it was prescribing depreciation rates for larger telephone companies. See p. 4, above. While the FCC has regularly consulted with the state commission staffs and received information from them, the FCC itself has prescribed the depreciation rates. Once the FCC has prescribed depreciation, the states normally have followed FCC depreciation decisions.[55]

Louisiana's brief, ranging over 50 years of history, has found exactly *one* reported case approving an actual state deviation in the determination of depreciation. That case, which petitioners repeatedly cite as an "*e.g.*" without any other example, is a California decision which *approved* remaining life even before the FCC had done so.[56] The decision deserves no weight because, in discussing state authority over depreciation, it did not even address Section 220 of the Act.[57]

Even if the FCC had read the Act differently over many years and even if past practice were flatly inconsistent with its

[55] *Virginia State Corporation Commission* v. *FCC, supra*, 737 F.2d at 394 (Cal. Pet. App. A-13-14); *In re Amendment of Part 31, supra*, 89 F.C.C.2d at 1106 (Cal. Pet. App. A-45). Louisiana gains no support from state regulation that *preceded* depreciation decisions by the FCC. As this Court held in construing Section 20(5), the states were permitted to prescribe depreciation "*until* the Interstate Commerce Commission could act administratively to prescribe rates." *Northwestern Bell Tel. Co.* v. *Nebraska State Ry. Comm'n*, 297 U.S. 471, 478-79 (1936) (emphasis added). See also *Smith* v. *Illinois Bell Tel. Co.*, 282 U.S. 133, 159-60 (1930).

[56] *Pacific Tel. & Tel. Co.* v. *Public Utils. Comm'n*, 401 P.2d 353 (Cal 1965). *Southern Bell Tel. & Tel. Co.*, 66 P.U.R.3d 1 (Fla. 1966), proclaimed state authority but actually followed the FCC's depreciation prescriptions.

[57] Most of Louisiana's examples involve state creation of sub-accounts or related matters. From the outset, the FCC has given blanket approval allowing telephone companies to maintain sub-accounts requested by state commissions so long as the state requirements do not frustrate the basic FCC accounting regime. See *Telephone Division, Order No. 7-C*, 1 F.C.C. 45 (1935); 47 C.F.R. §§ 31.01-2(d)(1), (f).

present position, the FCC could adopt a new reading and alter past practice when justified by new circumstances.[58] No such justification is required in this case. Before the present controversy, the states generally did follow FCC depreciation decisions. Requiring continued state respect for FCC depreciation decisions will maintain the actual *status quo ante*—state respect for FCC depreciation decisions—as it has existed for over a half century.

II. THE FCC LAWFULLY PREEMPTED INCONSISTENT STATE REGULATION OF DEPRECIATION WHICH FRUSTRATED FEDERAL POLICY AND CONFLICTED WITH FEDERAL RULES.

Although Congress itself may preempt state authority either explicitly or by implication, statutory preemption is *not* the only basis on which state authority may be superseded. As this Court recently explained, "federal regulations have no less pre-emptive effect than federal statutes" and "a preemptive regulation's force does not depend on express congressional authorization to displace state law." [59] Independent of statutory preemption under Section 220(b), the FCC lawfully invoked agency preemption in this case to preempt state regulation. Such agency preemption was justified both to avoid the frustration of federal policy and because inconsistent state regulation conflicts with federal depreciation rules.

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[58] *E.g., American Trucking Ass'ns* v. *Atchison, T.&S.F.Ry.*, 387 U.S. 397, 416 (1967) ("the Commission, faced with new developments or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968).

[59] *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta, supra*, 458 U.S. at 153-54 (emphasis added). Compare decisions of this Court refusing to preempt *because* the federal agency declined to do so. *E.g., Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983); *Hillsborough County* v. *Automated Medical Laboratories, Inc.*, 105 S.Ct. 2371 (1985).

A. The FCC Reasonably Found That Inconsistent State Regulation of Depreciation for Subject Carriers Would Frustrate Federal Policy.

Less than two years ago, this Court in the *Crisp* case [60] expressly affirmed the FCC's power to preempt state regulation to avoid frustration of federal policy, stating:

> "[I]f the FCC has resolved to pre-empt an area of . . . regulation and if this determination 'represents a *reasonable accommodation* of conflicting policies' that are within the agency's domain, . . . we must conclude that all conflicting state regulations have been precluded." 104 S. Ct. at 2701 (emphasis added and footnote omitted).

A uniform line of decisions upholding FCC preemption exists in the courts of appeals, including cases in the First Circuit,[61] Second Circuit,[62] Fourth Circuit,[63] and District of Columbia Circuit.[64] This preemptive power has been crucial in implementing the FCC's major policy reforms, including connection of customer-provided telephone sets to the network, competition in intercity communication, and provision of telephone equipment and computer related services on a competitive basis.[65]

In this case, the FCC's intent is clear (92 F.C.C.2d at 879 (Cal. Pet. App. A-79)) and it rests on an explicit, ultimate finding that "it is essential to preempt inconsistent state depreciation practices to avoid frustration of . . . vital national policies" discussed in its decision. *Id.* at 878 (Cal. Pet. App. A-

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[60] *Capital Cities Cable, Inc.* v. *Crisp, supra*, 104 S. Ct. 2694.

[61] *Puerto Rico Tel. Co.* v. *FCC*, 533 F.2d 694 (1st Cir. 1977).

[62] *New York Tel. Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *Brookhaven Cable TV, Inc.* v. *Kelly*, 573 F.2d 765 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1979).

[63] *NCUC I, supra*, 537 F.2d 787; *NCUC II, supra*, 552 F.2d 1036.

[64] *Computer and Comm'ns Indus. Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983) ("*Computer II*"); *People of the State of California* v. *FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978).

[65] See *NCUC II, supra*, 552 F.2d 1036; *New York Tel. Co.* v. *FCC, supra*, 631 F.2d 1059; *Computer II, supra*, 693 F.2d 198.

78). Under the "reasonable accommodation" standard of *Crisp*, the governing inquiry is whether the FCC had a rational basis for this ultimate finding. A rational basis exists because, as the FCC amply demonstrated, inconsistent state depreciation would frustrate federal objectives to which the FCC's 1980 and 1981 reforms had been directed.

As the FCC explained in adopting its 1980 and 1981 depreciation rules, accurate depreciation plays several critical roles in this capital intensive industry. It permits effective rate of return regulation by regulators, properly depicts a carrier's financial health for investors, and assures the timely recovery of invested capital to provide the carrier's management with the incentive and wherewithal for new investment. 83 F.C.C.2d at 271-75 (J.A. 8-15). These functions depend on the use of depreciation methods and rates that accurately measure the consumption of capital. *Id.* at 271-72 (J.A. 8-10).

The enormous reserve deficiency that now exists in the telephone industry shows that prior depreciation has not kept pace with actual capital consumption. One reason is that vintage group depreciation and whole life have a built-in tendency to defer depreciation so that it lags behind actual consumption. See pp. 6, 7, above. Deferred depreciation is increasingly dangerous in a period of rapid technological change and increasing competition. 83 F.C.C.2d at 281, 287, 290 (J.A. 23-24, 31-32, 35-36).[66] The overwhelming evidence before the FCC showed, and the FCC so found, that the use of SLELG and remaining life does produce more accurate capital recovery based on better measurements of actual straight line

[66] As already noted, competition has a double effect on depreciation: it stimulates technological innovation, shortening the useful service life of existing and newly installed plant; and it increases the risk that if investment is not fully recovered over the life of the plant, competition will prevent telephone rates from being maintained to recoup the undepreciated investment.

depreciation than the prior methods. 83 F.C.C.2d at 281 (J.A. 23).[67] Given the FCC's expertise, its technical findings on this issue would have to be sustained even if they were open to review.[68]

The FCC was not concerned with abstract perfection for its own sake but with an urgent practical problem of assuring timely capital recovery to create the means and incentive for new investment in the telephone network. Capital recovery that matches the actual rate of depreciation, the result that SLELG and remaining life helped to achieve, stimulates new investment both by increasing cash flow and by reducing the risk that new investment will not be fully recovered.[69] See pp. 26, 27 n. 74, below. Moreover, it is this new investment that is primarily responsible for *reducing* the ultimate rates charged to telephone customers over the long run and permitting them to enjoy the benefits of a "communication service with adequate facilities at reasonable charges." Section 1 of the Act.[70]

Here, the FCC rationally found that the state commissions' refusal to follow the new and more accurate depreciation methods would frustrate FCC policy and impair the network. 92 F.C.C.2d at 875-78 (Cal. Pet. App. A-73-78). As the FCC

[67] The FCC's finding of greater accuracy was supported by expert evidence from major accounting firms, Coopers & Lybrand and Arthur Andersen, by the American Institute of Certified Public Accountants, and by a lengthy study by Ernst & Ernst. *Id.* at 278-80 (J.A. 20-23).

[68] NARUC and the state commissions participating in the FCC proceedings never sought direct review of the 1980 and 1981 depreciation rules, and the time for doing so has long since expired. 28 U.S.C. § 2344.

[69] Conversely, "[a]rtificially retarded depreciation hurts investment ability in two ways: it raises the cost of capital by contributing to perceptions of these firms as poor risks, and it diminishes their ability to fund investment internally, since depreciation provides a source of internal cash." NTIA Report 140-41.

[70] Long-distance telephone rates fell steadily after World War II largely because new investment in advanced long-distance transmission systems, capable of handling much larger volumes of traffic at even lower cost per unit, were installed throughout the network. Similarly, both local and long-distance rates have been held down primarily because the telephone companies have substituted automatic switching systems for operators at switchboards; and this evolution is now entering a new phase as electronic switching systems are substituted for electro-mechanical ones.

explained, the vast bulk of telephone plant in the United States is "used interchangeably to provide interstate and intrastate communications." *Id.* at 877 (Cal. Pet. App. A-75-76). Much of the investment in both existing and new telephone plant is assigned by the FCC, in its separations rules, to be recovered through intrastate rates. Depreciation is the means by which that investment is recovered.

If the interstate rates include depreciation computed through accurate depreciation methods but the intrastate rates do not, a substantial portion of the investment in common plant would be recovered too slowly or not at all. 92 F.C.C.2d at 876-77 (Cal. Pet. App. A-75-76). New investment would be discouraged to the detriment of the entire network. *Id.* Put differently, a telephone company pays for 100 percent, not 25 percent, of a new cable or system; if the new cable or switch is not acquired when needed because a state refuses to allow adequate depreciation of the portion of the plant assigned to intrastate service, then it is interstate as well as intrastate service that suffers.[71]

In sum, the FCC rationally found that the use of inconsistent depreciation methods by the states would frustrate the very reforms the FCC sought to implement in 1980 and 1981. Similarly, NTIA, after a thorough study, recently confirmed the threat of "frustration of [federal telecommunications] policies should states successfully resist FCC or court mandates on depreciation recovery for future investment." NTIA Report 139. The FCC's appraisal is ample basis for its decision to preempt. The question, as this Court emphasized in *Crisp*, is not whether the FCC's judgment enjoys "universal support." 104 S. Ct. at 2705. Instead, it is whether the federal agency has "acted arbitrarily," and the reviewing court's inquiry is a "limited" one.[72]

[71] The FCC also relied upon other benefits of a uniform depreciation regime. In particular, it found that such a regime would reduce difficulties encountered when assets commonly used in interstate and intrastate service are converted from regulated to unregulated service (92 F.C.C.2d at 876-77 (Cal. Pet. App. A-75-76)) and that such a regime helps ensure proper separation of commonly used property between the interstate and intrastate rate bases. *Id.* at 878 (Cal. Pet. App. A-77-78).

[72] *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta, supra*, 458 U.S. at 154. See also *United States* v. *Shimer*, 367 U.S. 374. 381-82 (1961).

The California brief—but not the Louisiana brief—makes a frontal attack on the reasonableness of the FCC's decision to preempt. California asserts that state constitutions and statutes already require state regulators to allow "timely capital recovery." Calif. Br. 35-36. This bland assurance ignores the fact that capital recovery that is merely "timely" enough to avoid confiscation and meet state statutory standards is not invariably the same as recovery that will keep the telephone network in step with the challenges and opportunities of rapidly changing technology and consumer needs.[73] "Most state regulators perceive political pressure to keep local telephone rates as low as possible" (NTIA Report 139) even though "[i]n the longer term, faulty depreciation policy will raise rates and diminish service quality to all users." *Id.* at 140. Moreover, the FCC did not preempt in this case until it first found that a significant number of states were refusing to follow the FCC methods. See p. 9 n.23, above.

California further argues that preemption will not spur plant replacement because it has only an indirect effect on new investment. Calif. Br. 36. However, as the FCC found, timely depreciation does spur new investment (83 F.C.C.2d at 281 (J.A. 23-24)), and the relationship between faster depreciation and increased investment has been recognized for years.[74] California also complains that the FCC has not required that new funds generated by timely depreciation be committed to plant replacement. Calif. Br. 36. However, the carriers' past track record shows that they will continue to modernize without compulsion if capital is available and the risk of unduly delayed cost recovery is overcome.

[73] In this very case, the objections that NARUC and a number of state commissions made to the FCC in opposing SLELG did not rest on any doubts about its accuracy but merely on the states' desire not to increase short-run revenue requirements. See 83 F.C.C.2d at 278 (J.A. 20).

[74] Timely depreciation increases cash flow to permit new investment with reduced outside borrowing, reduces the risk for management in making new investment, and may even reduce the cost of borrowing outside capital if faster recovery reduces investor risk. See 1 A. Kahn, *The Economics of Regulation: Principles and Institutions* 117-22 (1970); P. Garfield & W. Lovejoy, *supra*, at 109-11.

Finally, California claims that faster and more accurate depreciation would frustrate the FCC's own desire to promote competition by telephone companies because higher prices for services will decrease the carriers' ability to market their services. Calif. Br. 37. On the contrary, carrier investments are often made precisely because new facilities will permit service at *lower* cost over the life of the plant in question and this fact is borne out by the history of modernized telephone plant and lower telephone rates for the last 50 years. See p. 27, above.[75] FCC depreciation does not require increased rates for particular competitive services but merely ensures that overall carrier revenue requirements allow for actual depreciation.[76]

B. Inconsistent State Regulation Conflicts With the FCC's Depreciation Rules.

State regulation is preempted not only where it frustrates federal agency policy but also where there is a conflict between a specific federal-agency rule and an inconsistent state action. It has been settled for years that a valid federal regulation preempts conflicting state law, and "[t]he relative importance to the State of its own law is not material . . . for the Framers of our Constitution provided that the federal law must prevail." [77]

In 1980 and 1981, the FCC established new rules to govern depreciation of telephone plant commonly used for interstate and intrastate service. See pp. 6-8, above. The FCC has express authority under Section 2(a) over "all interstate . . . communication by wire or radio" which includes all telephone

[75] Indeed, the competitors of regulated carriers do generally use faster depreciation rates. NTIA Report 135-41.

[76] Because telephone plant is commonly used for a number of different services, the states in designing or approving the design of charges for individual intrastate services can help ensure that the telephone companies' competitive position is not improperly impaired. 92 F.C.C.2d at 874 (Cal. Pet. App. A-70-71).

[77] *Free* v. *Bland, supra,* 369 U.S. at 666 (Treasury regulation creating right of survivorship in U.S. Savings Bonds preempts inconsistent Texas community property law).

[78] Sections 3(a) and (b), 47 U.S.C. §§ 153(a), (b), include in the definition of communication all "instrumentalities, facilities [and] apparatus . . . incidental to" transmission.

plant incidental to such transmission.[78] This telephone plant, even where it lies solely within one state, is subject to the FCC's depreciation authority so long as it is used or usable for interstate communication.[79]

The FCC exercised its authority by adopting rules approving the use of SLELG and remaining life depreciation for carriers subject to the Act and determining that such carriers are entitled to utilize those methods. See pp. 6-8, above. The FCC has also now held that its rules are intended to apply to determining depreciation of such telephone plant, whether the subject carriers are participating in an FCC or a state agency proceeding. 92 F.C.C.2d at 879-80 (Cal. Pet. App. A-78-79). The FCC's reading of its own rules could scarcely be disputed especially where, as here, it has shown *why* that reading is necessary to give effect to the underlying purpose of the rules. See pp. 23-28, above.[80]

State commissions are acting in direct contravention of the FCC's new depreciation rules where they preclude carriers from using SLELG or remaining life in state proceedings. It is irrelevant whether the FCC has made use of SLELG and remaining life mandatory or merely elective for the carrier.[81] Where the FCC's rules intend that a carrier be given an option, a state's attempt to deprive the carrier of such an option is no less a conflict with the FCC's determination.[82]

[79] *E.g., United States* v. *Southwestern Cable Co.,* 392 U.S. 157 (1968); *Ward* v. *Northern Ohio Tel. Co.,* 300 F.2d 816 (6th Cir.), *cert. denied,* 371 U.S. 820 (1962).

[80] *E.g., Ford Motor Credit Co.* v. *Milhollin,* 444 U.S. 555, 566 (1980) ("[a]n agency's construction of its own regulations has been regarded as especially due that respect"); *Udall* v. *Tallman,* 380 U.S. 1, 16-17 (1965).

[81] The FCC has made the use of SLELG elective for the carriers, rather than mandatory, because some telephone companies do not yet have the capability to implement SLELG. 83 F.C.C.2d at 284-85 (J.A. 27-30).

[82] The FCC's telephone equipment registration rules, sustained in *NCUC II,* permit rather than require customers to connect their own telephones to the network, but it is settled that these rules preempt any state interference with this option to connect. See *NCUC I,* 537 F.2d at 790, 793-94. Similarly, when the FCC preempted states and local entry regulation of satellite master antenna television, it did not compel anyone to provide that service but merely prevented the states from depriving potential providers of their option to offer the service. *New York State Comm'n on Cable Television* v. *FCC,* 749 F.2d 804, 805-06 (D.C. Cir. 1984).

Although the FCC was concerned with the overall threat to its policies, it did confront a specific instance of state conflict with FCC depreciation rules in this case. General Telephone Company of Ohio sought to compute its depreciation in proceedings before the Ohio Commission using the same SLELG and remaining life computations that were approved by the FCC's depreciation rules. Even though the resulting depreciation rates had actually been prescribed by the FCC, the Ohio Commission refused to recognize the FCC's rules and orders as controlling. The conflict between the FCC's rules and inconsistent state action was therefore not an abstract possibility, but an actual event, and that conflict was specifically addressed by the FCC in this case and formed part of the basis of its determination. See 92 F.C.C.2d at 865, 879-80 (Cal. Pet. App. A-55, 79-80).

A state ban on SLELG or remaining life forbids the carriers to do precisely what the FCC rules permit. Such state action, like the Oklahoma advertising ban struck down in *Crisp*, "plainly conflicts with specific federal regulations." 104 S.Ct. at 2703. Thus, the preemption of state regulation is required not only to avoid frustration of the purpose underlying the FCC's rules but also to avoid conflict with the rules themselves. This conflict provides a further basis for agency preemption in this case.

III. SECTION 2(b)(1) DOES NOT BAR EITHER STATUTORY OR AGENCY PREEMPTION IN THIS CASE.

Both the Louisiana and California briefs place substantial weight on Section 2(b)(1) of the Communications Act.[83] California reads this section as qualifying whatever preemptive effect might otherwise flow from Section 220 itself. Calif. Br. 14-16. Both California and Louisiana argue that Section 2(b)(1) restricts the FCC's own authority to preempt. *E.g.*, La. Br. 22. The states' interpretation of Section 2(b)(1) is at

[83] That section provides that subject to the radio licensing provisions, the Act does not apply or give the FCC authority over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." 47 U.S.C. § 152(b)(1).

odds with its language, its legislative history and a uniform line of authority interpreting it.[84]

A. The Specific Treatment of Depreciation in Section 220 Governs in This Case.

The language and legislative history of Section 220 of the Act show that Congress had a clear intent that the FCC determine depreciation methods of subject carriers and that, when the FCC has done so, state agencies are not entitled to require different depreciation rates for the same telephone plant. See pp. 12-19, above. In fact, Congress in 1934 directly considered whether Section 220 should be amended to give the states a right to adopt such separate depreciation rates and refused to grant such authority. *Id.* In short, Section 220 specifically resolves the preemption question in favor of federal authority and does so based on specific congressional intent.

However Section 2(b)(1) might be read in other situations, there is no way that it can be read to override the specific congressional determination to preempt state authority over depreciation. As this Court said in *Fourco Glass Co.* v. *Transmirra Products Corp., supra,* 353 U.S. at 228-29:

> "[T]he law is settled that 'However inclusive may be the general language of a statute, it "will not be held to apply to a matter specifically dealt with in another part of the same enactment. . . . Specific terms prevail over the general in the same or another statute which might otherwise be controlling." *Ginsberg & Sons* v. *Popkin,* 285 U.S. 204, 208.' "

This principle has been repeatedly followed by this Court and by lower courts and directly applies in this case.[85]

[84] The state commissions also refer in passing to Section 221(b) of the Act, 47 U.S.C. § 221(b), but its legislative history shows that this provision was directed to the narrow problem, not involved in this case, of local exchanges overlapping state lines. See, *e.g.*, *Computer II, supra,* 693 F.2d at 216-17 & nn. 103, 104, citing legislative history and the decisions of three other circuits.

[85] See *MacEvoy Co.* v. *United States,* 322 U.S. 102, 107 (1944); *Ginsberg & Sons, Inc.* v. *Popkin,* 285 U.S. 204, 208 (1932); *AT&T* v. *FCC,* 487 F.2d 865 (2d Cir. 1973).

To read Section 2(b)(1)'s general language to override Section 220's specific treatment of depreciation would also conflict with the internal evidence in Section 220 itself. As the states interpret Section 2(b)(1), carriers subject to the Act would be forced, contrary to the express language of Section 220(b), to "charge . . . a percentage of depreciation other than that prescribed therefor by the [FCC]." 47 U.S.C. § 220(b). Carriers would be "except[ed]" from requirements of Section 220 by state rather than FCC action. Compare Section 220(h). And the states would no longer be confined to providing their "views and recommendations" to the FCC on proposed depreciation changes, in accordance with Section 220(i), but would be able to dictate depreciation for much of the telephone plant in the United States.

The states' reading also defies the specific congressional purpose. In 1920, Congress adopted the predecessor of Section 220(b), requiring the ICC to fix depreciation rates, in order to "put[ ] an end to the existing system under which there are as many different systems of depreciation as there are carriers." [86] In the Communications Act of 1934, Congress reenacted the language of the Interstate Commerce Act reflecting this requirement, and after debate expressly rejected "the requests of the State Commissions that the present law be changed" so that they could adopt their own "methods of depreciation accounting." [87] It is inconceivable that Congress intended to frustrate these specific decisions as to depreciation by general language in Section 2(b)(1).

B. The States' Reading of Section 2(b)(1) Is Inconsistent With Its Language and Its Legislative History.

The defining phrase in Section 2(b)(1)—including the references to charges, classifications, practices and regulations—closely parallels similar defining language used repeatedly in Sections 201-05 of the Act, 47 U.S.C. §§ 201-05.[88] Sections 201-05 directly govern the carriers' rate and service relationships with their customers and not their depreciation or accounting. The term "charges" is repeatedly used in Sections 201-05 to refer to customer charges, and the "classifications," "practices" and "regulations" referred to are those that delineate the customer charges for services provided to customers.[89] Similarly, the cases under Sections 201-05 treat the classifications, regulations and practices there described as those bearing upon customer charges.[90]

Reading the language of Section 2(b)(1) *in pari materia* with the same language in Sections 201-05, it becomes clear that Congress was concerned in Section 2(b)(1) with *customer* charges and not *depreciation* charges. Similarly, the practices, classifications and regulations referred to in Section 2(b)(1) are those that delineate customer charges for intrastate services; Congress was not attempting to preserve state authority over practices, classifications or regulations for depreciation and accounting, a subject which it had entrusted the FCC to regulate under Section 220. This basic distinction is a complete answer to the states' linguistic argument.

This reading of Section 2(b)(1) is confirmed by its legislative history. The origin of the pertinent subparagraph (1)—reserving state authority over "intrastate communication"—is undisputed. The provision was proposed by the state commissions in reaction to the Court's earlier decision in

[86] H.R. Rep. No. 456, 66th Cong., 1st Sess. 31 (1919), explaining language adopted in Section 20(5) of the Interstate Commerce Act and now contained in Section 220(b) of the Communications Act. See p. 15, above.

[87] H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934), explaining proposed Section 220(j), which Congress refused to enact.

[88] Section 201(b), 47 U.S.C. § 201(b), requires that "charges, practices, classifications, and regulations" for interstate service be "just and reasonable." Section 202(a), 47 U.S.C. § 202(a), forbids unreasonable discriminations or preferences in "charges, practices, classifications, regulations, facilities, or services." Sections 203-05, 47 U.S.C. §§ 203-05, contain similar language.

[89] Section 201(a), for example, refers to the "charges" for through routes and the "divisions of such charges," referring to the amounts charged by carriers to customers and the need to divide the revenues between the carriers where a joint through charge is made. Similarly, Section 203(a) requires carriers to publish tariffs showing "all charges" between points served on its system or connecting carriers and showing "the classifications, practices and regulations affecting such charges."

[90] *E.g.*, *AT&T* v. *FCC*, 572 F.2d 17 (2d Cir.), *cert. denied*, 439 U.S. 875 (1978); *AT&T* v. *FCC*, *supra*, 449 F.2d 439.

the *Shreveport Rate Case*, holding that the ICC had power to order an increase in specific intrastate railroad rates charged to customers where necessary to eliminate discrimination against interstate commerce.[91] In other words, Section 2(b)(1) was from the outset concerned with protection against federal preemption of the states' setting of individual customer charges for specific intrastate services.[92]

This restriction is *not* violated by the FCC's Preemption Order. Depreciation comprises only about 10-15 percent of revenue requirements, and it does not determine the ultimate charges at either the interstate or intrastate level. The level of rates to be charged for individual intrastate services is fixed only after the aggregate "revenue requirement" for all intrastate services has been determined, and depreciation is only one of a number of elements that affect each carrier's revenue requirement.[93] Once the revenue requirement is determined, the state commission then approves or permits specific rates for individual intrastate services to be fixed so that the total expected revenue from those rates will match the carrier's total intrastate revenue requirement.[94]

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[91] *Houston, E. & W. Texas Ry.* v. *United States*, 234 U.S. 342 (1914) ("*Shreveport Rate Case*"). The hostility of the state commissions to *Shreveport*, and their design of Section 2(b), is undisputed. *E.g., Hearings on S. 2910, supra*, at 155 (statement of NARUC representative).

[92] State commissions properly had far more reason to be concerned about *Shreveport* and the federal determination of intrastate rates than about depreciation. The ICC, which continued to retain its *Shreveport* powers over intrastate railroad rates, used this authority for many years to order general adjustments in intrastate railroad rates.

[93] The intrastate revenue requirement equals return on net investment attributable to intrastate service (computed by using the rate of return allowed on such investment by the state commission) plus the predicted ongoing expenses of the carrier in providing intrastate service including operating expenses, depreciation and taxes.

[94] This phase, often called rate design, involves a range of choices because there are various mixes of rates for different services that can add up to the same revenue requirement. Ultimately, the rate for each service, multiplied by the expected volume of service at that rate, produces an estimated total revenue for the service; and the final mix is set so that the sum of these revenues for all of the services matches the revenue requirement.

Thus, the FCC by determining depreciation affects only one element in this complicated equation, and the FCC does not determine the ultimate intrastate customer charge for *any* intrastate service when it determines depreciation under Section 220(b) any more than when it separates investment between federal and state rate bases pursuant to Section 221(c). Nor is there any automatic relationship between a change in depreciation and a change in the rate ultimately charged to customers for any individual intrastate service. This basic point was expressly conceded by the states in the court below. As the Virginia Commission stated:

> "The [FCC] preemption order affects neither the myriad of other factors affecting the total revenue requirement, which must be derived from the aggregate of individual prices, *or the prices for individual services* (rate design)."[95]

Section 2(b) cannot be extended beyond its established purpose as revealed in the legislative history. At most, Congress intended in the disputed language of Section 2(b) to negate *Shreveport* and to prevent the FCC from fixing the rates charged to customers for individual intrastate services. Congress did not mean, as the states now contend, that the FCC is precluded from determining issues merely because those determinations *affect* intrastate rates. The FCC affects intrastate rates every day in the exercise of its express powers under the Act.[96] To read Section 2(b)(1) to bar such effects is not merely implausible but impossible.

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[95] Brief of the Virginia Commission, p. 37 (emphasis added) in the Fourth Circuit in this case, joined by other state commissions including California, Florida and Ohio.

[96] Separations rules (47 C.F.R. § 67.1, *et seq.*) adopted by the FCC under Sections 221(c) and 410(c) govern many more accounts than depreciation alone and ultimately affect intrastate rates far more pervasively than do FCC depreciation rules. Similarly, FCC rules permitting connection of customer provided equipment to the network (47 C.F.R. § 68.1, *et seq.*) and detariffing carrier provided telephone sets and similar equipment (47 C.F.R. § 64.702) affect both carrier revenues and carrier costs at the intrastate level.

C. A Uniform Line of Court of Appeals Decisions Squarely Rejects the States' Interpretation.

There is an additional reason, persuasive to four courts of appeals, why Section 2(b)(1) cannot apply in this case. Sections 1 and 2(a) of the Act give the FCC overriding authority over interstate communication; and, with qualifications, Section 2(b)(1) reserves to the state commissions authority over certain aspects of intrastate communication. From the outset, the appellate courts have recognized that the bare language of these provisions does not resolve cases where there is an *overlap* of interstate and intrastate concerns.[97] Resolving such "overlap" issues in favor of federal supremacy, the courts of appeals have repeatedly interpreted Section 2(b)(1) as confined to intrastate matters which are "separable from and do not substantially affect" interstate communication.[98]

This reading of Section 2(b)(1), three times reaffirmed by the Fourth Circuit, has also been adopted by the First Circuit, the Second Circuit, and the District of Columbia Circuit in numerous decisions.[99] This Court denied certiorari in a number of these same cases. No court of appeals has reached an inconsistent conclusion or read Section 2(b)(1) in the fashion urged by petitioners. This uniform judicial interpretation, reading the Act to affirm federal supremacy on common issues,

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[97] See, *e.g., NCUC I, supra,* 537 F.2d at 792, where Judge Hastie observed that juxtaposing the language of these sections "creates the . . . dispute but, considered alone, does not resolve it."

[98] See *Computer II, supra,* 693 F.2d at 215, quoting *NCUC I, supra,* 537 F.2d at 793. *NCUC I* held: "section 2(b) deprive[s] the [FCC] of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *Id.*

[99] First Circuit: *Puerto Rico Tel. Co.* v. *FCC, supra,* 553 F.2d 694. Second Circuit: *New York Tel. Co.* v. *FCC, supra,* 631 F.2d 1059; *Brookhaven Cable TV, Inc.* v. *Kelly, supra,* 573 F.2d 765. Fourth Circuit: *NCUC I, supra,* 537 F.2d 787; *NCUC II, supra,* 557 F.2d 1036; *Virginia State Corp. Comm'n* v. *FCC, supra,* 737 F.2d 388 (Cal. Pet. App. A-1); *Fort Mill Tel. Co.* v. *FCC,* 719 F.2d 89 (4th Cir. 1983). D.C. Circuit: *Computer II, supra,* 693 F.2d 198; *People of the State of California* v. *FCC, supra,* 567 F.2d 84; *NARUC* v. *FCC,* 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied,* 105 S. Ct. 1224 (1985).

is the foundation for many of the FCC's major regulatory initiatives that are now part of the structure of the telecommunications industry. See, *e.g.,* p. 36, n. 99, above.

This Court has not definitively construed Section 2(b)(1), but the courts of appeals' interpretation is consistent with, and strongly supported by, this Court's decisions in the related area of cable television. In those cases, this Court has generally upheld FCC regulation of cable television, where found necessary by the agency, *despite* the effect on local activities or displacement of local regulation.[100] Cable television systems are local facilities, they have no physical connection to an interstate network, and the Act's specific provisions do not give the FCC any express authority over cable television. The present case involves the physically integrated, federally regulated interstate telephone network. The FCC's exercise of preemptive power over matters of common concern affecting the telephone network should be sustained even more readily than its authority over cable television already upheld by this Court.

If this Court confirms the reading of Section 2(b)(1) uniformly adopted in the lower federal courts, that ends the petitioners' objection. *NCUC I* said that Section 2(b) applies only to local matters that are "separable from and do not substantially affect" interstate communication. 537 F.2d at 793. Because the same telephone plant is used interchangeably for interstate as well as intrastate communication, as was true in *NCUC I* and is true in this case, the facilities are clearly not "separable from" interstate communication; and the determination of depreciation rates for such plant, whether applied in FCC or state proceedings, does "substantially affect" the con-

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[100] See, *e.g., United States* v. *Southwestern Cable Co., supra,* 392 U.S. 157; *Capital Cities Cable, Inc.* v. *Crisp, supra,* 104 S. Ct. 2694. *Southwestern Cable,* the leading case in this line, was directly relied upon by a number of courts of appeals decisions construing Section 2(b)(1). *E.g., People of the State of California* v. *FCC, supra,* 567 F.2d at 86; *New York Tel. Co.* v. *FCC, supra,* 631 F.2d at 1066.

duct and development of interstate communications. The FCC so found in this case,[101] and the states' attack upon the findings is without merit. See pp. 24-26, above.

Over 15 years ago, the Chief Justice, then sitting as a judge on a court of appeals, considered the relation of Sections 2(a) and 2(b) in an opinion sustaining FCC regulation of cable television. After reviewing this Court's precedents, the Chief Justice held that the Act has given the FCC adequate power to fulfill its "comprehensive and pervasive" responsibilities.[102] He continued:

> "Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by a central authority; fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." *Id.*

What was true of cable television in 1969 is vastly more true today of the telephone network itself. On certain regulatory issues, there must be "a central authority," and only the FCC can perform that role. *Id.* Otherwise, coherent regulation is impossible and the nation's "unified system of communication" will not achieve the goals established by Congress in Section 1 of the Act. *Id.*[103]

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[101] "Here the setting of depreciation rates is not an essentially local incident or practice and it has substantial effects upon the administration and development of the interstate telephone network." 92 F.C.C.2d at 875 (Cal. Pet. App. A-72).

[102] *General Tel. Co.* v. *FCC, supra,* 413 F.2d at 401 (Burger, J.).

[103] This interpretation of the Act does not preclude a meaningful role for the states in regulating telecommunications. Recent events have left the state agencies with a full agenda, including problems of intrastate rate design, local deregulation, and intrastate competition (see NTIA Report 104-29), and the FCC has increased its efforts to consult. *E.g., MTS and WATS Market Structure,* 50 Fed. Reg. 939 (1985) (adopting joint board recommendations on access charges). It does mean that on issues of common concern where a single voice is essential, the FCC's decision must prevail.

CONCLUSION

For the reasons stated, the Fourth Circuit's decision upholding the FCC Preemption Order should be affirmed.[104]

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[104] The appeal of the Louisiana Commission should be dismissed for want of jurisdiction. *Silkwood* v. *Kerr-McGee Corp.,* 104 S. Ct. 615, 620-21 (1984).

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November 1985

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APPENDIX A[1]

SUBSCRIBING PARTIES

American Telephone and Telegraph Company
The Bell Telephone Company of Pennsylvania
The Chesapeake and Potomac Telephone Company
The Chesapeake and Potomac Telephone Company of Maryland
The Chesapeake and Potomac Telephone Company of Virginia
The Chesapeake and Potomac Telephone Company of West Virginia
Cincinnati Bell Telephone Company
Continental Telecom, Inc.
The Diamond State Telephone Company
Illinois Bell Telephone Company
Indiana Bell Telephone Company
Michigan Bell Telephone Company
The Mountain States Telephone and Telegraph Company
New England Telephone and Telegraph Company
New Jersey Bell Telephone Company
New York Telephone Company
North American Telecommunications Association [2]
Northwestern Bell Telephone Company
The Ohio Bell Telephone Company
Pacific Northwest Bell Telephone Company
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
The Southern New England Telephone Company
Southwestern Bell Telephone Company
United Telephone System, Inc.
Wiconsin Bell Inc.

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[1] The listing required by S. Ct. R. 28.1 is contained in the joint motion to dismiss and opposition to certiorari filed by the subscribing parties in these cases. In addition to the companies there listed, FiberLan, Inc. should now be included as a partly-owned subsidiary of BellSouth Corporation.

[2] Formerly North American Telephone Association.

APPENDIX B

RELEVANT STATUTORY PROVISIONS

Section 2 of the Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C. § 152)

"(a) The provisions of this chapter shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio communication or transmission wholly within the Canal Zone. The provisions of this chapter shall apply with respect to cable service, to all persons engaged within the United States in providing such service, and to the facilities of cable operators which relate to such service, as provided in subchapter V-A of this chapter.

(b) Except as provided in section 224 of this title and subject to the provision of section 301 of this title and subchapter V-A of this chapter, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing

business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carrier to which clause (2) or clause (3) of this subsection would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 to 205 of this title shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4) of this subsection."

Section 220 of the Communications Act of 1934, ch. 652, 48 Stat. 1064, 1078 (codified as amended at 47 U.S.C. § 220)

"(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the clasess [sic] of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided,* That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

(f) No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books or other accounts, as hereinbefore provided, except insofar as he may be directed by the Commission or by a court.

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this chapter and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates."

Section 20(5) of the Interstate Commerce Act, added by the Transportation Act of 1920, ch. 91, 435, 41 Stat. 456, 493-94 (codified at 49 U.S.C. § 1144)

"(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. The commission shall at all times have access to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by carriers subject to this Act, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing and kept or required

to be kept by such carriers. This provision shall apply to receivers of carriers and operating trustees. The provisions of this section shall also apply to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, kept during the period of Federal control, and placed by the President in the custody of carriers subject to this Act."

H.R. 8301, 73rd Cong., 2d Sess. § 220(j) (1934)

"(j) Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class or property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices, or (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law."

APPENDIX C

DESCRIPTION OF SLELG AND REMAINING LIFE

The Straight Line Equal Life Group Method

Assume that a group of six telephone poles installed at the same time have predicted service lives, based on past experience, such that out of any such group of six, two can be expected to be retired from service at the end of three years, two more at the end of four years, and the remaining two at the end of the fifth year. Under the vintage group method, all six poles would be treated as a group because their "vintage" or year of installation is the same.

Treated as a group, they have an "average" estimated life of four years, because total number of estimated years of use for the group is 24 years (2 x 3 years plus 2 x 4 years plus 2 x 5 years) and the number of poles is six (24 ÷ 6 = 4). A four year life yields an average rate of depreciation for the group of 25 percent a year.[1] If the poles cost $60 apiece, and have no salvage value after retirement, then the net investment would be $360. Under the vintage group method, the telephone company would determine its yearly depreciation expense by multiplying the 25 percent depreciation rate times the cost of the poles remaining in service during the year. The resulting yearly depreciation expense for the group is as shown in the following table:

	Year					Total
	1	2	3	4	5	
Three year poles	$30	$30	$30	—	—	$ 90
Four year poles	30	30	30	30	—	120
Five year poles	30	30	30	30	30	150
Total:	$90	$90	$90	$60	$30	$360

[1] This 25 percent depreciation rate would produce an annual depreciation expense of $15 for each pole in service ($60 x 25 percent).

The total depreciation expense is $360, the total cost of the six poles. However, the depreciation expense for the three year poles is only $90, $30 less than their cost. That shortfall is made up by an equal overdepreciation of the five year poles. Thus, the vintage group method defers full recognition of the depreciation of the shorter lived poles until the retirement of the longer lived poles.

Under SLELG, the same group of six poles would be depreciated in three separate subgroups, each group containing two poles estimated to have the same useful life. The two poles estimated to last three years would be depreciated at 33⅓ percent a year, the four year subgroup would be depreciated at 25 percent a year, and the five year subgroup would be depreciated at 20 percent per year.[2] This results in the yearly expense shown in the following table:

	Year					Total
	1	2	3	4	5	
Three year poles	$40	$40	$40	—	—	$120
Four year poles................	30	30	30	30	—	120
Five year poles.................	24	24	24	24	24	120
Total:........................	$94	$94	$94	$54	$24	$360

The total depreciation expense is again $360, the total cost of the six poles. But under SLELG, full depreciation of each pole is recognized by the time of retirement of the pole. There is no deferral of the recognition of depreciation for the shorter lived poles.

Remaining Life

Assume that a new type of central-office switch first installed at the beginning of 1975 is expected to last for 20 years

[2] These depreciation rates would produce an annual depreciation expense of $20 for each three year pole ($60 x 33⅓ percent), $15 for each four year pole ($60 x 25 percent), and $12 for each five year pole ($60 x 20 percent).

and then to become obsolete even though still functioning mechanically. To eliminate problems of grouping, assume for the sake of illustration that depreciation is tracked individually for each switch. The estimated life of 20 years yields a depreciation rate of 5 percent a year. If the switch originally cost $1,000,000 and is expected to have no salvage value, a depreciation charge of $50,000 per year would be recorded.

Now assume further that after five years of depreciation has been taken amounting to $250,000 (5 years x $50,000 per year), a new technological development occurs in 1980 that makes clear that the switch will become obsolete in five more years and will be replaced in 1985, rather than in 1995 as originally estimated. If the new development had been foreseen in 1975, the estimated useful life for the switch would have been set at 10 years and the investment would have been depreciated at 10 percent per year. The question now is what kind of mid-course correction to make.

The solution used in the past, called "whole life," was to adopt in 1980 a new depreciation rate for the partly depreciated switch based on the ten year life (10 percent a year) and apply it prospectively for the remaining five years. The difficulty is that when the switch is retired at the end of 1984, the total accrued depreciation expense, denominated the "depreciation reserve," will be only $750,000.[3] On retirement there will prove to be a significant under-recovery of investment ($250,000 or 25 percent), technically a "deficiency" in the depreciation reserve.

The "remaining life" method solves this problem of under-recovery of depreciation. It provides that, when useful life of the switch is re-estimated in 1980, the *remaining* undepreciated investment ($750,000) is recovered over the course of the *remaining* useful life as it is now more accurately estimated (five more years). Since at the start of 1980 there remains 75 percent of the original investment to be recovered over the

[3] The figure represents $250,000 for 1975 through 1979 ($50,000 a year for five years) plus $500,000 from 1980 through 1984 ($100,000 a year for five years).

remaining five years, the new depreciation rate for the last five years is set at 15 percent per year (75 percent divided by 5).

At the end of the switch's useful life at the end of 1984, the total depreciation expense recorded will exactly equal the full original investment. In the example given, actual depreciation at retirement will equal $1,000,000, 100 percent of the investment.[4]

[4] Five percent a year from 1975 through 1979 (25 percent) plus 15 percent a year from 1980 through 1984 (75 percent).